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DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 570

[Docket No. FR-5181-F-02]

RIN 2506-AC22

**State Community Development Block Grant Program:
Administrative Rule Changes**

AGENCY: Office of the Assistant Secretary for Community Planning and Development, HUD.

ACTION: Final rule.

SUMMARY: This final rule makes changes to several sections of the regulations for the Community Development Block Grant (CDBG) program for states (State CDBG program). This final rule streamlines and updates the regulations to reflect statutory changes, clarifies the program income requirements, provides other clarifications to the State CDBG program regulations, and makes a conforming change to the regulations applicable to the CDBG Entitlement program. This final rule also provides additional flexibility to states in their administration of the program. The final rule follows publication of an October 17, 2008, proposed rule and takes into consideration the public comments received on the proposed rule.

DATES: Effective Date: **[INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].**

FOR FURTHER INFORMATION CONTACT: Eva C. Fontheim, Community Planning and Development Specialist, Office of Community Planning and Development, Department of Housing and Urban Development, 451 Seventh Street, SW, Room 7182, Washington, DC 20410; telephone number 202-708-1322 (this number is not toll-free). Individuals with speech or

hearing impairments may access this number through TTY by calling the toll-free Federal Relay Service at 800-877-8339.

SUPPLEMENTARY INFORMATION

I. Background

On October 17, 2008, at 73 FR 61757, HUD published for public comment a proposed rule that would revise HUD's regulations for the State CDBG program in 24 CFR part 570, subpart I, in order to conform the regulations to current statutory requirements concerning program income, and to provide additional flexibility to states in implementing their programs. Title I of the Housing and Community Development Act of 1974 (42 U.S.C. 5301-5320) (HCDA) established the statutory framework for the CDBG program. The primary statutory objective of the CDBG program is to develop viable communities, by providing decent housing and a suitable living environment and by expanding economic opportunities, principally for persons of low- and moderate-income. HUD's regulations implementing the CDBG program are located in 24 CFR part 570 (entitled "Community Development Block Grants").

Under the State CDBG program, states have the opportunity to administer CDBG funds for nonentitlement areas. Nonentitlement areas include those units of general local government that do not receive CDBG funds directly. States participating in the State CDBG program award grants only to units of general local government that carry out development activities. Annually, each state develops funding priorities and criteria for selecting projects. HUD's role under the State CDBG program is to ensure state compliance with federal laws, regulations, and policies. The regulations for the State CDBG program are codified in subpart I of the part 570 regulations.

The proposed regulatory amendments described in the October 17, 2008, proposed rule were designed to clarify how HUD will administer the State CDBG program. HUD proposed to

streamline and update the regulations to reflect statutory changes, clarify the program income requirements, and provide other clarifications to the State CDBG regulations that will provide states with additional flexibility in their administration of the program. Interested readers should refer to the preamble to the October 17, 2008, proposed rule for additional information on the proposed regulatory changes to the State CDBG program.

II. This Final Rule; Changes to the October 17, 2008, Proposed Rule

This final rule follows publication of the October 17, 2008, proposed rule and takes into consideration the public comments received on the proposed rule. The public comment period on the proposed rule closed on December 16, 2008. HUD received eight responses. Commenters included one public interest group and seven units of local government. Most of the public comments pertained to the provisions of the proposed rule concerning program income requirements.

After careful consideration of the issues raised by the commenters, HUD has decided to adopt an amended version of the proposed rule. Specifically, HUD has made the following changes to the October 17, 2008, proposed rule:

1. Administrative Expense Cap Time Period. The final rule clarifies, at § 570.489(a)(1), that the program income included in the calculation determining the amount of allowable administrative and technical assistance per program year is all of the program income received in the program year, regardless of the fiscal year in which the state grant funds were appropriated that generated the program income.

2. Identifies Parties in the Grant Agreement for Calculating Program Income. Section 570.489(e)(2)(v) of the final rule specifies that the grant agreement referred to in this section is between the state and the unit of general local government.

3. Entitlement Jurisdictions Receive Only an Incidental Benefit from State CDBG

Program Expenditures. The final rule, at § 570.486(c), no longer mandates that entitlement jurisdictions receive only an incidental benefit from State CDBG program expenditures. Instead, if State CDBG program funds are expended on activities located in entitlement jurisdictions, the activities must significantly benefit residents of the state grant recipient, must meet the nonentitlement jurisdiction's needs, and the entitlement jurisdiction must make a meaningful contribution to the project.

4. State Action Plans Including a Return of Program Income Requirement on Local

Governments. The final rule clarifies, at §570.489(e)(3)(ii)(A), that states that intend to require units of general local government to return program income to the state, after the action plan is already submitted and approved by HUD, may submit a substantial amendment.

III. Discussion of Public Comments on the October 17, 2008, Proposed Rule

The following section presents a summary of the significant issues raised by the public comments in response to the October 17, 2008 proposed rule, and HUD's responses to those issues.

The summary of public comments is organized by category: section III.A. discusses the administrative cap, section III.B. discusses program-income requirements, section III.C. discusses spending funds outside a jurisdiction of the recipient, and section III.D. discusses audits.

A. Comments on the Administrative Expense Cap

Comments: Several commenters posed the following questions: "What is the time period used to calculate the amount of program income received by the units of local government? Is it the amount received from the preceding year? The preceding 2 years? If the

state is able to add additional program income to the current allocation to increase the administrative costs, where does the program income come from – the annual allocation to the state or the program income funds that come back to the local grantees?”

HUD response. To determine the program income portion of the administrative expense cap, program income is counted in the program year that it is received by the unit of general local government, or by the unit of general local government’s subgrantee. As noted above, HUD has revised § 570.489 to clarify that the program income included in the calculation determining the amount of allowable administrative and technical assistance per program year is all of the program income received in the program year, regardless of the fiscal year in which the state grant funds were appropriated that generated the program income. For example, if the state is determining the administrative cap for program year 2011, then the program income received by the unit of general local government in 2011 is used in the calculation. The program income that is used as part of the calculation to determine the administrative cap is the program income that is received by the unit of general local government during each program year regardless of which year’s allocation of funds generated the program income. The administrative cap is based on the state’s grant, program income, and reallocated funds received by the state in the program year. This sets the maximum State CDBG program funds that the state may expend on administration.

Comment: Increase the administrative cap. Two commenters suggested that HUD support an increase to the administrative cap.

HUD Response. The administrative cap is a statutory requirement. Accordingly, because the change requested by the commenters is outside HUD’s authority, no change has been made to the proposed rule in response to those comments.

B. Comments on Program Income Requirements

Comment: The program income threshold should be raised from \$35,000 to \$50,000.

Three commenters expressed appreciation that the program income threshold was increased from \$25,000 to \$35,000; however, they felt that by increasing it further to \$50,000, the states would be further relieved of administrative requirements for program income.

HUD Response. HUD has not revised the proposed rule in response to these comments. As noted in the preamble to the proposed rule, HUD's proposal to increase the annual threshold to \$35,000 was to account for inflation that occurred since the program income threshold was increased to \$25,000 in 1995. As a result, any CDBG income below \$35,000 would not be considered program income and would therefore not be subject to CDBG requirements, including tracking and reporting of program income. The higher amount requested by the commenters would exceed the adjustment required for inflation.

Comment: Concerning the Requirements that States Include the Use of Program Income Retained by Local Governments in their Annual Performance and Evaluation Reports (PERs).

Six commenters wrote that the changes to the program income requirements would create an administrative burden that would be duplicative of reports already submitted by states. One commenter questioned if the state would need to amend its PER if a unit of local government were late reporting its program income. Another commenter suggested that program income tracking should discontinue 5 years after closeout of the grant between the state and the unit of general local government to be consistent with the 5-year continued use requirements. Another commenter thought the language in the proposed rule was confusing regarding the "proceeds from the sale of real property purchased or improved with CDBG funds, if the proceeds are received more than 5 years after the expiration of the grant agreement." The commenter

suggested that the final rule should identify whether the grant agreement is between HUD and the state or the unit of general local government and the state.

HUD Response. HUD is responsible to taxpayers for ensuring that all CDBG program funds are spent in compliance with CDBG program requirements and regulations. In order to fulfill this responsibility, it is necessary that states report to HUD on all program income whether retained by units of general local government or paid to the state, to ensure that all program income is accounted for and is used for eligible activities. States, in turn, need to require that local governments report on program income. It is the state's responsibility to collect program income data from their units of general local government in a timely manner so that the data can be included in the annual PER. States should make findings against units of general local government that do not report program income in a timely manner. If a state receives program income data after the PER due date, the data must be included in the PER the following year with an explanation.

The requirement for states to track program income indefinitely is governed by section 104(j)(2) of the HCDA (42 U.S.C. 104(j)(2)), which mandates that program income is indefinite and subject to all the CDBG requirements even after the grant is closed out between the state and the unit of general local government. However, HUD recognizes the potential administrative burdens imposed on states by the reporting requirement and has made two modifications to the proposed rule in response to the suggestions raised by the commenters. First, the final rule revises § 570.489(e)(2)(v), by clarifying that proceeds received from the sale of real property acquired or improved in whole or part with CDBG funds will not be considered program income if the proceeds are received more than 5 years after expiration of the grant agreement and are, therefore, exempt from being tracked. Further, HUD has adopted the suggestion to identify the

parties to the grant agreement. The final rule specifies that the grant agreement is “between the state and the unit of general local government.”

Comments: Concerning the Requirement to Add Program Income Data for Local Governments into the Integrated Disbursement and Information System (IDIS). Six commenters wrote that the IDIS reporting requirement is an additional burden on the already heavy CDBG administrative workload. Another commenter suggested that the reporting requirements should be reduced to annually instead of quarterly. Two commenters requested additional time to phase in compliance because many local partners are small organizations that do not have the administrative capacity to comply immediately. One commenter wrote that it is burdensome to include loan receipts in both IDIS and the paper PER. One commenter requested that HUD be more specific about what data are to be collected and in what format.

HUD Response. HUD has not revised the proposed rule in response to these comments. HUD is cognizant of the potential administrative burdens that may be imposed by the reporting requirements and has attempted to craft a regulation that fulfills HUD’s oversight responsibilities while minimizing such burdens. As an initial matter, HUD notes that the revised regulations recommend, but do not mandate quarterly reporting on IDIS. The final rule establishes an annual IDIS reporting requirement. HUD encourages states to enter IDIS data quarterly as a way to keep the data and reporting current and spread out the states’ workload during the year. Quarterly entry of data would better enable both grantees and HUD to report accomplishments to community development stakeholders. Moreover, HUD also notes that the PER reporting is now automated in IDIS, making reporting less burdensome to states and more user-friendly. HUD has also provided guidance for reporting in the Notice: CPD-11-03, “Reporting Requirements for

the State Performance and Evaluation Report,” which can be accessed at the following link:

http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/notices/cpd.

Comments: Regarding Program Income Retained at the Local Level. Two commenters objected to the provision of the proposed rule stating that if program income on hand exceeds projected cash needs for the reasonably near future, the state may require the local government to return all or part of the program income to the state until such time as the program income is needed by the local government. The commenters questioned why a state would want to require local governments to return program income to it until the local government is able to spend it. The commenters wrote that the proposed regulatory provision would create accounting difficulties for states and local governments, and risk the prospect of state accounts having insufficient funds when the local government is ready to spend its program income. The commenters advocated that the final rule provide greater flexibility to states in addressing program income.

HUD Response. With the exception of a clarifying change, HUD has not revised the proposed rule in response to these comments. HUD already provides the state with maximum feasible deference to decide whether to require a unit of general local government to return all or a portion of program income to the state in cases where the local government’s program income exceeds projected cash needs for that same activity in the near future. A state that requires local governments to return program income in this instance must return the program income to the local government when it is needed to carry out the same activity from which it was derived. The advantage to the states utilizing this option is to keep the program income liquid and available to other local governments that are in need of immediate funding. Although HUD is leaving it up to the states to determine whether to allow units of general local government to

retain their program income, states must have a method to ensure that funds are available to those units of general local government that are looking to receive their funds back to continue the same project activity. Further, each state is permitted to define “continuing the same project activity.”

HUD also provides flexibility for states to choose whether to allow units of local government to retain the program income to implement another eligible CDBG activity under 24 CFR 570.489(e)(3)(ii)(A). If the state finds the unit of general local government is funding a different CDBG activity from which the program income was originally derived, the state may request that the locality return the program income entirely or when the income generated meets a specific threshold. States can employ one or more methods to ensure that local governments comply with applicable program income requirements. In addition, with HUD Field Office approval, the state can design its own method that will ensure compliance with the program income requirements by units of general local government. As noted, HUD has made a clarifying change to the following provision of the proposed rule. Proposed §570.489(e)(3)(ii)(A) would have required states to indicate in their action plans their intent to require units of general local government to return program income. This final rule clarifies that a state may also indicate such intent in a substantial amendment to the plan in the event that the action plan has already been submitted and approved by HUD.

C. Comments on Spending Funds Outside the Jurisdiction of the Recipient

Comment: Definitions needed. Two comments were made that the term “significantly benefit,” as used in the following phrase, “State CDBG-funded activities must significantly benefit residents of the grant recipient’s jurisdiction,” needs to be defined. A definition for “incidental benefit,” as used in the sentence “residents of Entitlement jurisdiction may not

receive more than an incidental benefit from the state grantee's expenditure of funds," was also requested. Additionally, a comment was made that states should be given more flexibility to partner and share resources and solutions in a more regional approach that encourages smart growth and sustainable development.

HUD Response. Section 106(d)(1) of the HCDA (42 U.S.C. 106(d)(1)), allocates 30 percent of CDBG program funds to states for use in nonentitlement areas. The intent of this section of the HCDA is for the funds to significantly benefit nonentitlement areas. Allocation amounts for states are based on the demographics of each state's nonentitlement communities and are intended for use in nonentitlement areas. Entitlement grantees receive their own CDBG allocation based on the demographics of their jurisdictions. If it is more practical and feasible for an activity to be located within the boundaries of an entitlement community to benefit nonentitlement residents, the entitlement community is expected to provide a reasonable share of the CDBG program funds if the entitlement community benefits from the activity as well. An example would be locating a senior center in an entitlement city that is served by public transportation from outlying areas of the city. HUD has decided not to define "significant benefit" at this time but will provide maximum feasible deference to each state's interpretation of this term.

HUD has taken into consideration the comment concerning the use of a more regional approach that would allow projects to benefit jurisdictions within nonentitlement and entitlement areas. HUD has modified the rule to be less restrictive, at the same time emphasizing that the funding must significantly benefit the state grantee's residents. Additionally, there have been more proposals recently that have involved funding projects in entitlement jurisdictions, and HUD has decided to modify the proposed rule in 24 CFR 570.486(c), to remove the requirement

that entitlement jurisdictions receive only an incidental benefit from State CDBG program expenditures. State CDBG program funds still must be used to significantly benefit the residents of the unit of general local government receiving the grant and cannot be used to provide significant benefit to an entitlement jurisdiction unless the entitlement grantee provides a meaningful contribution to the project. The new regulatory requirement at 570.486(c) supersedes HUD's policy memo to all State CDBG program grantees on "State CDBG Activities benefiting Entitlement Community Residents," dated May 26, 2006.

D. Comment on Audits

Comment: The commenter is concerned that states will be held responsible for guaranteeing their grantees' compliance with the Single Audit Act rather than ensuring that CDBG grants are awarded only to localities that can provide professional certification from an auditor that demonstrates compliance.

HUD Response. The rule revises 24 CFR 570.489(m), by including language that audits be conducted in accordance with 24 CFR 85.26(a), which incorporates compliance with the Single Audit Act and the provisions of the Office of Management and Budget (OMB) Circular A-133 (62 FR 35278). This is not an additional requirement of § 570.489(m), but an update to replace the citation to 24 CFR part 44 with section 85.26(a). It is a statutory requirement that states must comply with the requirements of the Single Audit Act and OMB Circular A-133; therefore, states are responsible to ensure that their funded localities are in compliance.

IV. Findings and Certifications

Public Reporting Burden

The information collection requirements contained in this rule have been approved by OMB under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB

control number 2506-0085. In accordance with the Paperwork Reduction Act, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information, unless the collection displays a currently valid OMB control number.

Environmental Impact

In accordance with HUD regulations in 24 CFR part 50 that implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332(2)(C)), a Finding of No Significant Impact with respect to the environment was made at the proposed rule stage and remains applicable to this final rule. The Finding is available for public inspection during regular business hours in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW, Room 10276, Washington, DC 20410-0500. Due to security measures at the HUD Headquarters building, please schedule an appointment to review the Finding by calling the Regulations Division at 202-402-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Relay Service at 800-877-8339.

Executive Order 13132, Federalism

Executive Order 13132 (entitled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial direct compliance costs on state and local governments and is not required by statute, or the rule preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Order. This rule does not have federalism implications and would not impose substantial direct compliance costs on state and local governments nor preempt state law within the meaning of the Order.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments and the private sector. This final rule does not impose a federal mandate on any state, local, or tribal government, or the private sector within the meaning of UMRA.

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 et seq.) generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. This rule would revise certain requirements that apply to the management of CDBG funds, program income, and other administrative matters by state governments. The changes will not impose new economic burdens on states and local governments participating in the State CDBG program. Rather, as detailed in the preamble to this final rule, the regulatory amendments will codify existing HUD policy, update obsolete provisions, or revise regulations to reflect statutory language. Therefore, the undersigned certifies that this rule will not have a significant impact on a substantial number of small entities.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance (CFDA) program number for the State CDBG program is 14.228, and the CFDA program number for the Entitlement program is 14.218.

List of Subjects in 24 CFR Part 570

Administrative practice and procedure, American Samoa, Community Development Block Grants, Grant programs-education, Grant programs-housing and community development, Guam, Indians, Loan programs-housing and community development, Low and moderate income housing, Northern Mariana Islands, Pacific Islands Trust Territory, Puerto Rico, Reporting and recordkeeping requirements, Student aid, Virgin Islands.

Accordingly, for the reasons described in the preamble, HUD amends 24 CFR part 570, as follows:

PART 570 -- COMMUNITY DEVELOPMENT BLOCK GRANTS

1. The authority citation for part 570 continues to read as follows:

Authority: 42 U.S.C. 5300-5320.

2. In § 570.480, revise paragraph (a) and add paragraphs (f) and (g), to read as follows:

§ 570.480 General.

(a) This subpart describes policies and procedures applicable to states that have permanently elected to receive Community Development Block Grant (CDBG) funds for distribution to units of general local government in the state's nonentitlement areas under the Housing and Community Development Act of 1974, as amended (the Act). Other subparts of part 570 are not applicable to the State CDBG program, except as expressly provided otherwise. Regulations of part 570 outside of this subpart that apply to the State CDBG program include §§ 570.200(j) and 570.606.

* * * * *

(f) In administering the CDBG program, a state may impose additional or more restrictive provisions on units of general local government participating in the state's program, provided that such provisions are not inconsistent with the Act or other statutory or regulatory provisions that are applicable to the State CDBG program.

(g) States shall make CDBG program grants only to units of general local government. This restriction does not limit a state's authority to make payments to other parties for state administrative expenses and technical assistance activities authorized in section 106(d) of the Act.

3. In § 570.486, revise paragraph (b) and add paragraph (c), to read as follows:

§ 570.486 Local Government requirements.

* * * * *

(b) Activities serving beneficiaries outside the jurisdiction of the unit of general local government. Any activity carried out by a recipient of State CDBG program funds must significantly benefit residents of the jurisdiction of the grant recipient, and the unit of general local government must determine that the activity is meeting its needs in accordance with section 106(d)(2)(D) of the Act. For an activity to significantly benefit residents of the recipient jurisdiction, the CDBG funds expended by the unit of general local government must not be unreasonably disproportionate to the benefits to its residents.

(c) Activities located in Entitlement jurisdictions. Any activity carried out by a recipient of State CDBG program funds in entitlement jurisdictions must significantly benefit residents of the jurisdiction of the grant recipient, and the State CDBG recipient must determine that the activity is meeting its needs in accordance with section 106(d)(2)(D) of the Act. For an activity

to significantly benefit residents of the recipient jurisdiction, the CDBG funds expended by the unit of general local government must not be unreasonably disproportionate to the benefits to its residents. In addition, the grant cannot be used to provide a significant benefit to the entitlement jurisdiction unless the entitlement grantee provides a meaningful contribution to the project.

4. Amend § 570.489 as follows:

- a. Revise paragraphs (a)(1), (b), and (c);
- b. Add paragraphs (d)(2)(iii)(A) and (d)(2)(iii)(B);
- c. Revise paragraphs (e)(1), (e)(2), (e)(3)(i), and (e)(3)(ii);
- d. Add paragraphs (e)(3)(iii), (e)(3)(iv), and (e)(4);
- e. Revise the first sentence of paragraph (f)(2);
- f. Revise paragraph (m); and
- g. Add paragraph (n) to read as follows:

§ 570.489 Program administrative requirements.

(a) Administrative and planning costs. (1) State administrative and technical assistance costs. (i) The state is responsible for the administration of all CDBG funds. The state shall pay from its own resources all administrative expenses incurred by the state in carrying out its responsibilities under this subpart, except as provided in this paragraph (a)(1)(i) of this section, which is subject to the time limitations in paragraph (a)(1)(iv) of this section. To pay administrative expenses, the state may use CDBG funds not to exceed \$100,000, plus 50 percent of administrative expenses incurred in excess of \$100,000. Amounts of CDBG funds used to pay administrative expenses in excess of \$100,000 shall not, subject to paragraph (a)(1)(iii) of this section, exceed 3 percent of the sum of the state's annual grant, program income received by units of general local government during each program year, regardless of the fiscal

year in which the state grant funds that generate the program income were appropriated (whether retained by units of general local government or paid to the state), and of funds reallocated by HUD to the state.

(ii) To pay the costs of providing technical assistance to local governments and nonprofit program recipients, a state may, subject to paragraph (a)(1)(iii) of this section, use CDBG funds received on or after January 23, 2004, in an amount not to exceed 3 percent of the sum of its annual grant, program income received by units of general local government during each program year, regardless of the fiscal year in which the state grant funds that generate the program income were appropriated (whether retained by units of general local government or paid to the state), and funds reallocated by HUD to the state during each program year.

(iii) The amount of CDBG funds used to pay the sum of administrative costs in excess of \$100,000 paid pursuant to paragraph (a)(1)(i) of this section and technical assistance costs paid pursuant to paragraph (a)(1)(ii) of this section must not exceed 3 percent of the sum of a state's annual grant, program income received by units of general local government during each program year, regardless of the fiscal year in which the state grant funds generate the program income were appropriated (whether retained by the unit of general local government or paid to the state), and funds reallocated by HUD to the state.

(iv) In calculating the amount of CDBG funds that may be used to pay state administrative expenses prior to January 23, 2004, the state may include in the calculation the following elements only to the extent that they are within the following time limitations:

(A) \$100,000 per annual grant beginning with FY 1984 allocations;

(B) Two percent of the sum of a state's annual grant and funds reallocated by HUD to the state within a program year, without limitation based on when such amounts were received;

(C) Two percent of program income returned by units of general local government to states after August 21, 1985; and

(D) Two percent of program income received and retained by units of general local government after February 11, 1991.

(v) In regard to its administrative costs, the state has the option of selecting its approach for demonstrating compliance with the requirements of this paragraph (a)(1) of this section. Any state whose matching cost contributions toward state administrative expense matching requirements are in arrears must bring matching cost contributions up to the level of CDBG funds expended for such costs. A state grant may not be closed out if the state's matching cost contribution is not at least equal to the amount of CDBG funds in excess of \$100,000 expended for administration. Funds from any year's grant may be used to pay administrative costs associated with any other year's grant. The two approaches for demonstrating compliance with this paragraph (a)(1) of this section are:

(A) Cumulative accounting of administrative costs incurred by the state since its assumption of the CDBG program. Under this approach, the state will identify, for each grant it has received, the CDBG funds eligible to be used for state administrative expenses, as well as the minimum amount of matching funds that the state is required to contribute. The amounts will then be aggregated for all grants received. The state must keep records demonstrating the actual amount of CDBG funds from each grant received that were used for state administrative expenses, as well as matching amounts that were contributed by the state. The state will be considered to be in compliance with the applicable requirements if the aggregate of the actual amounts of CDBG funds spent on state administrative expenses does not exceed the aggregate maximum allowable amount and if the aggregate amount of matching funds that the state has

expended is equal to or greater than the aggregate amount of CDBG funds in excess of \$100,000 (for each annual grant within the subject period) spent on administrative expenses during its 3- to 5-year Consolidated Planning period. If the state grant for any grant year within the 3- to 5-year period has been closed out, the aggregate amount of CDBG funds spent on state administrative expenses, the aggregate maximum allowable amount, the aggregate matching funds expended, and the aggregate amount of CDBG funds in excess of \$100,000 (for each annual grant within the subject period) will be reduced by amounts attributable to the grant year for which the state grant has been closed out.

(B) Year-to-year tracking and limitation on drawdown of funds. For each grant year, the state will calculate the maximum allowable amount of CDBG funds that may be used for state administrative expenses, and will draw down amounts of those funds only upon its own expenditure of an equal or greater amount of matching funds from its own resources after the expenditure of the initial \$100,000 for state administrative expenses. The state will be considered to be in compliance with the applicable requirements if the actual amount of CDBG funds spent on state administrative expenses does not exceed the maximum allowable amount, and if the amount of matching funds that the state has expended for that grant year is equal to or greater than the amount of CDBG funds in excess of \$100,000 spent during that same grant year. Under this approach, the state must demonstrate that it has paid from its own funds at least 50 percent of its administrative expenses in excess of \$100,000 by the end of each grant year.

* * * * *

(b) Reimbursement of pre-agreement costs. The state may permit, in accordance with such procedures as the state may establish, a unit of general local government to incur costs for CDBG activities before the establishment of a formal grant relationship between the state and the

unit of general local government and to charge these pre-agreement costs to the grant, provided that the activities are eligible and undertaken in accordance with the requirements of this part and 24 CFR part 58. A state may incur costs prior to entering into a grant agreement with HUD and charge those pre-agreement costs to the grant, provided that the activities are eligible and are undertaken in accordance with the requirements of this part, part 58 of this title, and the citizen participation requirements of part 91 of this title.

(c) Federal grant payments. The state's requests for payment, and the Federal Government's payments upon such requests, must comply with 31 CFR part 205. The state must use procedures to minimize the time elapsing between the transfer of grant funds and disbursement of funds by the state to units of general local government. States must also have procedures in place, and units of general local government must use these procedures to minimize the time elapsing between the transfer of funds by the state and disbursement for CDBG activities.

(d) * * *

(2) * * *

(iii) * * *

(A) A state that opts to satisfy this requirement for fiscal controls and administrative procedures by applying the provisions of part 85 must comply with the requirements therein.

(B) A state that opts to satisfy this requirement for fiscal controls and administrative procedures by applying the provisions of part 85 of this title must also ensure that recipients of the state's CDBG funds comply with part 84 of this title, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations," as applicable.

(e) Program income. (1) For the purposes of this subpart, “program income” is defined as gross income received by a state, a unit of general local government, or a subgrantee of the unit of general local government that was generated from the use of CDBG funds, regardless of when the CDBG funds were appropriated and whether the activity has been closed out, except as provided in paragraph (e)(2) of this section. When income is generated by an activity that is only partially assisted with CDBG funds, the income must be prorated to reflect the percentage of CDBG funds used (e.g., a single loan supported by CDBG funds and other funds; or a single parcel of land purchased with CDBG funds and other funds). Program income includes, but is not limited to, the following:

(i) Proceeds from the disposition by sale or long-term lease of real property purchased or improved with CDBG funds, except as provided in paragraph (e)(2)(v) of this section;

(ii) Proceeds from the disposition of equipment purchased with CDBG funds;

(iii) Gross income from the use or rental of real or personal property acquired by the unit of general local government or subgrantee of the unit of general local government with CDBG funds, less the costs incidental to the generation of the income;

(iv) Gross income from the use or rental of real property, owned by the unit of general local government or other entity carrying out a CDBG activity that was constructed or improved with CDBG funds, less the costs incidental to the generation of the income;

(v) Payments of principal and interest on loans made using CDBG funds, except as provided in paragraph (e)(2)(iii) of this section;

(vi) Proceeds from the sale of loans made with CDBG funds, less reasonable legal and other costs incurred in the course of such sale that are not otherwise eligible costs under sections 105(a)(13) or 106(d)(3)(A) of the Act;

(vii) Proceeds from the sale of obligations secured by loans made with CDBG funds, less reasonable legal and other costs incurred in the course of such sale that are not otherwise eligible costs under sections 105(a)(13) or 106(d)(3)(A) of the Act;

(viii) Interest earned on funds held in a revolving fund account;

(ix) Interest earned on program income pending disposition of the income;

(x) Funds collected through special assessments made against nonresidential properties and properties owned and occupied by households not of low and moderate income, if the special assessments are used to recover all or part of the CDBG portion of a public improvement; and

(xi) Gross income paid to a unit of general local government or subgrantee of the unit of general local government from the ownership interest in a for-profit entity acquired in return for the provision of CDBG assistance.

(2) “Program income” does not include the following:

(i) The total amount of funds, which does not exceed \$35,000 received in a single year from activities, other than revolving loan funds that is retained by a unit of general local government and its subgrantees (all funds received from revolving loan funds are considered program income, regardless of amount);

(ii) Amounts generated by activities eligible under section 105(a)(15) of the Act and carried out by an entity under the authority of section 105(a)(15) of the Act;

(iii) Payments of principal and interest made by a subgrantee carrying out a CDBG activity for a unit of general local government, toward a loan from the local government to the subgrantee, to the extent that program income received by the subgrantee is used for such payments;

(iv) The following classes of interest, which must be remitted to HUD for transmittal to the Department of the Treasury, and will not be reallocated under section 106(c) or (d) of the Act:

(A) Interest income from loans or other forms of assistance provided with CDBG funds that are used for activities determined by HUD to be not eligible under § 570.482 or section 105(a) of the Act, to fail to meet a national objective in accordance with the requirements of § 570.483, or to fail substantially to meet any other requirement of this subpart or the Act;

(B) Interest income from deposits of amounts reimbursed to a state's CDBG program account prior to the state's disbursement of the reimbursed funds for eligible purposes; and

(C) Interest income received by units of general local government on deposits of grant funds before disbursement of the funds for activities, except that the unit of general local government may keep interest payments of up to \$100 per year for administrative expenses otherwise permitted to be paid with CDBG funds.

(v) Proceeds from the sale of real property purchased or improved with CDBG funds, if the proceeds are received more than 5 years after expiration of the grant agreement between the state and the unit of general local government.

(3) * * *

(i) Program income paid to the state. Except as described in paragraph (e)(3)(ii)(A) of this section, the state may require the unit of general local government that receives or will receive program income to return the program income to the state. Program income that is paid to the state is treated as additional CDBG funds subject to the requirements of this subpart. Except for program income retained and used by the state for administrative costs or technical assistance under paragraph (a) of this section, program income paid to the state must be

distributed to units of general local government in accordance with the method of distribution in the action plan under § 91.320(k)(1)(i) of this title that is in effect at the time the program income is distributed. To the maximum extent feasible, the state must distribute program income before it makes additional withdrawals from the Department of the Treasury, except as provided in paragraph (f) of this section.

(ii) Program income retained by a unit of general local government. A state may permit a unit of general local government that receives or will receive program income to retain the program income. Alternatively, subject to the exception in paragraph (e)(3)(ii)(A) of this section, a state may require that the unit of general local government pay any such income to the state.

(A) A state must permit the unit of general local government to retain the program income if the program income will be used to continue the activity from which it was derived. A state will determine when an activity will be considered to be continued, and HUD will give maximum feasible deference to a state's determination, in accordance with § 570.480(c). In making such a determination, a state may consider whether the unit of general local government is or will be unable to comply with the requirements of paragraph (e)(3)(ii)(B) of this section or other requirements of this part, and the extent to which the program income is unlikely to be applied to continue the activity within the reasonably near future. When a state determines that the program income will be applied to continue the activity from which it was derived, but that the amount of program income held by the unit of general local government exceeds projected cash needs for the reasonably near future, the state may require the local government to return all or part of the program income to the state until such time as the program income is needed by the unit of general local government. When a state determines that a unit of local government is not

likely to apply any significant amount of program income to continue the activity within a reasonable amount of time, or that it will not likely apply the program income in accordance with applicable requirements, the state may require the unit of general local government to return all of the program income to the state for disbursement to other units of local government. A state that intends to require units of general local government to return program income in accordance with this paragraph (e)(3)(ii)(A) of this section must describe its approach in the state's action plan required under § 91.320 of this title or in a substantial amendment if the state intends to implement this option after the action plan is submitted to and approved by HUD.

(B) Program income that is received and retained by the unit of general local government is treated as additional CDBG funds and is subject to all applicable requirements of this subpart, regardless of whether the activity that generated the program income has been closed out. If the grant that generated the program income is still open when the program income is generated, program income permitted to be retained will be considered part of the unit of general local government's grant that generated the program income. If the grant is closed, program income permitted to be retained will be considered to be part of the unit of general local government's most recently awarded open grant. If the unit of general local government has no open grants, the program income retained by the unit of general local government will be counted as part of the state's grant year in which the program income was generated. A state must employ one or more of the following methods to ensure that units of general local government comply with applicable program income requirements:

(1) Maintaining contractual relationships with units of general local government for the duration of the existence of the program income;

(2) Closing out the underlying activity, but requiring as a condition of closeout that the unit of general local government obtain advance state approval of either a unit of general local government's plan for the use of program income, or of each use of program income by grant recipients via regularly occurring reports and requests for approval;

(3) Closing out the underlying activity, but requiring as a condition of closeout that the unit of general local government notify the state when new program income is received; or

(4) With prior HUD approval, other approaches that demonstrate that the state will ensure compliance with the requirements of this subpart by units of general local government.

(C) The state must require units of general local government, to the maximum extent feasible, to disburse program income that is subject to the requirements of this subpart before requesting additional funds from the state for activities, except as provided in paragraph (f) of this section.

(iii) Transfer of program income to Entitlement program. A unit of general local government that becomes eligible to be an Entitlement grantee may request the state's approval to transfer State CDBG grant-generated program income to the unit of general local government's Entitlement program. A state may approve the transfer, provided that the unit of general local government:

(A) Has officially elected to participate in the Entitlement grant program;

(B) Agrees to use such program income in accordance with Entitlement program requirements; and

(C) Has set up Integrated Disbursement Information System (IDIS) access and agrees to enter receipt of program income into IDIS.

(iv) Transfer of program income of grantees losing Entitlement status. Upon entry into the State CDBG program, a unit of general local government that has lost or relinquished its Entitlement status must, with respect to program income that a unit of general local government would otherwise be permitted to retain, either:

(A) Retain program income generated under Entitlement grants and continue to comply with Entitlement program requirements for program income; or

(B) Retain the program income and transfer it to the State CDBG program, in which case the unit of general local government must comply with the state's rules for program income and the requirements of this paragraph (e).

(4) The state must report on the receipt and use of all program income (whether retained by units of general local government or paid to the state) in its annual performance and evaluation report.

(f) * * *

(2) The state may establish one or more state revolving funds to distribute grants to units of general local government throughout a state or a region of the state to carry out specific, identified activities. * * *

* * * * *

(m) Audits. Notwithstanding any other provision of this title, audits of a state and units of general local government shall be conducted in accordance with § 85.26 of this title, which implements the Single Audit Act (31 U.S.C. 7501-07) and incorporates OMB Circular A-133. States shall develop and administer an audits management system to ensure that audits of units of general local government are conducted in accordance with OMB Circular A-133, if applicable.

(n) Cost principles and prior approval. (1) A state must ensure that costs incurred by the state and by its recipients are in conformance with the following cost principles, as applicable:

(i) “Cost Principles for State, Local, and Indian Tribal Governments (OMB Circular A-87),” which is codified at 2 CFR part 225;

(ii) “Cost Principles for Non-Profit Organizations (OMB Circular A-122),” which is codified at 2 CFR part 230; and

(iii) “Cost Principles for Educational Institutions (OMB Circular A-21),” which is codified at 2 CFR part 220.

(2) All cost items described in Appendix B of 2 CFR part 225 that require federal agency approval are allowable without prior approval of HUD, to the extent that they otherwise comply with the requirements of 2 CFR part 225 and are otherwise eligible under this subpart I, except for the following:

(i) Depreciation methods for fixed assets shall not be changed without the express approval of HUD or, if charged through a cost allocation plan, of the cognizant federal agency.

(ii) Fines and penalties (including punitive damages) are unallowable costs to the CDBG program.

5. Add § 570.490(a)(3) to read as follows:

§ 570.490 Recordkeeping requirements.

(a) * * *

(3) Integrated Disbursement and Information System (IDIS). The state shall make entries into IDIS in a form prescribed by HUD to accurately capture the state’s accomplishment and funding data, including program income, for each program year. It is recommended that the state enter IDIS data on a quarterly basis and it is required to be entered annually.

* * * *

6. Add § 570.504(e) to read as follows:

§ 570.504 Program income.

* * * *

(e)(1) Transfer of program income to Entitlement program. A unit of general local government that becomes eligible to be an Entitlement grantee may request the state's approval to transfer State CDBG grant-generated program income to the unit of general local government's Entitlement program. A state may approve the transfer, provided that the unit of general local government:

- (i) Has officially elected to participate in the Entitlement grant program;
- (ii) Agrees to use such program income in accordance with Entitlement program requirements; and
- (iii) Has set up Integrated Disbursement and Information System (IDIS) access and agrees to enter receipt of program income into IDIS.

(2) Transfer of program income of grantees losing Entitlement status. Upon entry into the State CDBG program, a unit of general local government that has lost or relinquished its Entitlement status must, with respect to program income that a unit of general local government would otherwise be permitted to retain, either:

(i) Retain the program income generated under Entitlement grants and continue to comply with Entitlement program requirements for program income; or

(ii) Retain the program income and transfer it to the State CDBG program, in which case the unit of general local government must comply with the state's rules for program income and the requirements of § 570.489(e).

Dated: April 16, 2012

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